THE UNAUTHORIZED OR PROHIBITED EXERCISE OF CORPORATE POWER.

AMONG recent contributions to the literature of Corporation Law is a paper by Judge Seymour D. Thompson entitled "The Doctrine of Ultra Vires in relation to Private Corporations." [1] The essay is worthy of unusual attention, since it seems fair to assume that the views therein expressed will be reasserted in an expanded form in the forthcoming volumes of Judge Thompson's Commentaries.[2]

The learned author begins his discussion with a strong statement of his conviction "that the Anglo-American law" relating to "the so-called doctrine of *ultra vires*" is "in a state of hopeless and inextricable confusion." [3] He disclaims all intention of writing a treatise on the subject within the compass of a magazine article, but he addresses himself to an examination of principles and a statement of certain general conclusions. The discussion is cast in historical form. The author passes in review "the ancient doctrine of *ultra vires*"; he gives us the history of what he is pleased to call "the revolt" against it; he presents in outline the "modern doctrine"; and he concludes with a statement of his own views upon the ideal solution of the problems under discussion. If his treatment of the subject is true to the facts of legal history, the results of Judge Thompson's investigation will be accepted as an important contribution to legal literature. In the judgment of the present writer, however, there are in the essay certain points of no inconsiderable importance with respect to which there is room for at least an intelligent difference of opinion.

In the first place, it is not clear that any tribunal ever gave a consistent adherence to the doctrine which Judge Thompson calls "the ancient doctrine." In the second place, it may be doubted whether there is any justification for his view that modern developments of the law of Corporate Power are to be explained upon a

[1] 28 American Law Review, 376.

[2] Commentaries on the Law of Private Corporations. Bancroft-Whitney Co.: San Francisco, 1895. At the time of the writing of the present paper, the volume containing the chapters on Corporate Power has not made its appearance.

[3] Page 376.

principle of moral evolution. Again, it seems to be reasonably certain that those courts which to-day adhere to "the modern doctrine" have always recognized it in substantially its present form: in other words, it is not modern. Finally, it is submitted that much of importance is lost through a failure to recognize with distinctness the operation in this field of two opposing judicial conceptions of public policy. The more or less consistent following of one or the other of these has determined the attitude of all courts which have attempted the solution of problems of Corporate Power. It may not be unprofitable to examine these points in their order.

The "ancient doctrine" is thus stated by the learned author: —

"A contract of a corporation which is either unauthorized by or in violation of its charter or governing statute, or which is entirely outside the scope of the powers of its creation, is void, in the sense of being no contract at all because of the want of the power of the corporation to enter into it; that such a contract will not be enforced by any species of action in a court of justice; that, being void *ab initio*, it cannot be made good by *ratification;* nor by any succession of *renewals;* and that no *performance* on either side can give validity to it, so as to enable a party to the fund [to found?] any right of action upon it. The doctrine of the courts was, that, unless a corporation was empowered by its charter or governing statute to make a given contract, it was prohibited by the principles of the common law; that when a court of justice was appealed to for its enforcement, it stood upon the footing of any other prohibited illegal or immoral contract, and, as such, was subject to the operation of the principle, that a court of justice would not aid either party to enforce it, or to get back what he had lost under it, but would leave both parties in the predicament where, by their illegal act, they had placed themselves."

Assuming for the moment that this is the correct statement of an historical legal doctrine relating to unauthorized and prohibited contracts, it is important to note the misleading implication that, at the common law, the parties to all "prohibited illegal or immoral" contracts are helpless in respect of recovering what has been lost, and that the law, in such cases, will "leave both parties in the predicament where, by there illegal act, they have placed themselves." [1] Now the invalidity of an unauthorized corporate contract arises, not from the subject matter, but from the incapacity of one of the contracting parties. It is said to be

[1] Pages 378, 379.

illegal: but it is illegal, not because the agreement is itself immoral, but because the law denies the corporation power to enter into the agreement. It is *malum prohibitum* and not *malum in se.* It is therefore important to distinguish between "illegal prohibited contracts" and "illegal immoral contracts," which Judge Thompson seems to group together. The learned author would doubtless be ready to admit that, where the contract is prohibited merely, a plaintiff in default may recover at common law from the defendant (provided the contract is not wholly executed) to the extent that may be necessary to restore both parties to the *status quo.*[1] Again, where the defendant is in default and the plaintiff is not, the plaintiff, speaking generally, may recover in all cases in which the parties are not *in pari delicto.*[2] Indeed, Judge Thompson refers in another connection to these rights of recovery in quasi contract,[3] and he cites Lord Mansfield's decision in Moses *v.* Macferlan.[4] It follows, therefore, that the learned author speaks inadvertently when he assimilates to "any other prohibited contract" the case in which, for example, a railroad purchases and uses a steamboat and is absolved from all obligation to pay for it, and the further case in which an insurance company has made a prohibited loan and is cut off from all right to recover on the evidence of indebtedness.[5] If, as the learned author necessarily implies, the defendants retained there ill-gotten gains in these cases, they did so under the operation of a principle peculiar to the law of corporations, and altogether different from that which is applicable to other prohibited contracts at the common law. With these observations we pass to the first of the several questions proposed for discussion,—the question, that is, whether the "ancient doctrine" outlined by Judge Thompson ever did claim the allegiance of a court of common law. The two cases which have just been stated are used by Judge Thompson as the two leading illustrations of the doctrine under consideration. They are Pearce *v.* R. R. Co.[6] and Insurance Co. *v.* Lawrence.[7] In the former case the plaintiff, as indorsee of a promissory note, sued the corporation which had given the note to evidence an indebtedness for a steamboat made and delivered by the payee at the request of the corporation. The plaintiff could recover, if at all, only upon the contract, and the

[1] See Keener on Quasi Contracts, pp. 259 *et seq.*
[2] Ibid., pp. 267 *et seq.*
[3] Page 390.
[4] 2 Burr. 1005.
[5] Page 379.
[6] 21 How. 441.
[7] 3 Wend. 482.

court was of opinion that the contract was in excess of the defendant's corporate powers. But Mr. Justice Campbell is careful to observe that the court abstains from pronouncing any opinion upon the problem which would have arisen had the plaintiff been the vendor of the steamboat or an assignee of the vendor's interest. In other words, the liability of the defendant in a suit by the vendor in disaffirmance of the contract is not discussed. The case is not, therefore, an illustration of the "ancient doctrine." In the second of the two cases an insurance company, prohibited from discounting notes or engaging in the business of banking, nevertheless lent money upon promissory note secured by a pledge of corporate stock as collateral. In an action brought by the corporation as payee of the note, it was held that the action could not be maintained. There is here no decision to the effect that the plaintiff was without remedy. The right of recovery independently of contract is not negatived. Indeed, as is well known, another of these Utica Insurance Cases,[1] reported in the same volume of Wendell, (and cited, by the way, by Judge Thompson,) contains the remark of Chief Justice Savage to the effect that, though a prohibited security taken by the corporation is void, the plaintiff may nevertheless recover on the count for money lent. The soundness of this distinction between the validity of the security and of the contract of loan may be open to question;[2] but, in any event, the cases are not authorities for the proposition in support of which they are cited. While these cases are the only ones stated at length in the text as illustrations of the ancient doctrine, several others which deserve attention are cited in the notes. The most important of these are the decisions of Mr. Justice Gray in the Supreme Court of Massachusetts, and subsequently in the Supreme Court of the United States. These cases — Davis *v.* R. R. Co.[3] and Central Transportation Co. *v.* Pullman's Palace Car Co.[4] — were both actions based on contracts which the court treated as unauthorized. They are not in any sense ancient cases, the former having been decided in 1881, and the later in 1890. In the earlier case nothing in money or property appeared to have passed from plaintiff to defendant, so that the right of recovery in disaffirmance

[1] Utica Ins. Co. *v.* Cadwell, 3 Wend. 296.

[2] See remarks of Selden, J., in Tracy *v.* Talmage, 14 N. Y. 162; Keener on Quasi Contracts, p. 272.

[3] Davis *v.* Old Colony R. R. Co., 131 Mass. 258.

[4] Central Transportation Co. *v.* Pullman's Palace Car Co., 139 U. S. 24.

was not discussed, although distinctly recognized. In the later case the plaintiff unquestionably had a claim against the defendant to prevent the unjust enrichment of the latter. In point of fact, equitable proceedings in disaffirmance of the contract and for an accounting are to-day pending in the Circuit Court of the United States for the Eastern District of Pennsylvania.[1] The other cases cited need not be reviewed in detail. The writer, after careful consideration, ventures the assertion that in no one of them is there to be found a recognition of the doctrine outlined by the learned author. Possibly, therefore, Judge Thompson is unnecessarily severe when he asserts[2] that "such was the doctrine which our ancestral lawyers mouthed with owl-like wisdom, and which our ancestral judges rolled as a sweet morsel under their tongues."

The second point for examination is the "revolt against the doctrine of *ultra vires*." This judicial movement is treated by Judge Thompson as a moral reformation. He begins with some remarks to the effect that half the exertions of an advocate are put forth in maintaining the wrong side in legal controversies. Then follows this somewhat startling language: "The natural result is, that, when reasoning on legal subjects, lawyers, though upright and just in their private affairs, fall into the habit of dismissing conscience and of laying moral considerations out of view. This habit follows them when they ascend the bench as judges; it has settled like a fog over the professional intellect and conscience to such an extent that we now constantly hear from high sources the infamous proposition that there is no necessary connection between the law and concrete justice or morality." In such a state of moral chaos one could scarcely have hoped to find the germs of higher life. It might well have been feared that persistence in the practice of upholding the wrong for at least one half the time would have ended in the hopeless perversion of conscience and the destruction of the moral principle. But no: Judge Thompson assures us that the renaissance of conscience had its beginning when all that was good seemed about to perish. "Nevertheless, the judicial and professional conscience, dulled as it had been by this habit of reasoning in behalf of wrong, could not forever endure a rule of law which enabled one party to a contract, perfectly innocent when made between natural persons, to keep the fruits of it, and repudiate it

[1] No. 44, October Sessions, 1886. See report of one of the stages of this litigation in 65 Fed. Rep. 158.

[2] Page 380.

because it had been made with an artificial person having no power to make it." He then finds the first signs of the revolt of conscience in the "timid" suggestions from the bench that a recovery could be had by the aggrieved party,— not on the unauthorized contract, but in an action for money had and received. As an instance of the beginning of the reform he cites (among other cases) Pittsburgh, etc. R. R. Co. *v* Keokuk Bridge Co.,[1] decided as late at 1888, and involving on this head only such principles as the court had recognized long before. "Gradually," proceeds Judge Thompson, "the doctrine took a less technical and more intelligible form." He cites the case above referred to as one illustration of this advanced development, although he had already quoted it as an example of the beginning of reform. He then makes the following observation: "It cannot escape attention that the doctrine stated in this section was a great advance over the original conception that, as in the case of any other illegal or immoral contract, the law would not aid either party to an *ultra vires* contract, but would leave them in the condition where they had placed themselves, under the operation of the maxim *in pari delicto potior est conditio defendentis.* It was certainly a great stride to lay hold of the doctrine formulated by that great and just-minded judge, Lord Mansfield, that the party who had parted with his money under such a contract has a right of action on the principle of recovering money paid by mistake, or upon a consideration which has failed."

This observation, with its closing reference to Moses *v.* Macferlan,[2] at once brings into strong relief the assertion hazarded above, that the so called "modern doctrine" is in fact the doctrine to which the Supreme Court of the United States and certain other tribunals have adhered from the beginning. This was the third point proposed for examination. The assertion is really a corollary to the proposition that the "ancient doctrine" was never seriously put forth by any court. An examination of the opinions of Mr. Justice Gray in Davis *v.* Old Colony R. R. Co.,[3] and in Central Transportation Co. *v.* Pullman's Palace Car Co.,[3] will, it is submitted, make it clear that the position of these courts to-day is not inconsistent with that of Mr. Justice Campbell some forty years ago.[4] It is of course true that in modern times there has been a steady

[1] 131 U. S. 371. [2] 2 Burr. 1005. [3] *Supra.*
[4] Pearce *v.* R. R. Co., 21 How. 441.

movement in the direction of enforcing unauthorized and prohibited contracts as between the parties. It is insisted, however, that Judge Thompson's "ancient doctrine" was not the starting point of this movement, and that the movement has not manifested itself as part of a development of the right to recover in quasi contract. It is a movement which has resulted from a new judicial conception of public policy, and from a more or less careful study of the needs of the business world. It is a movement of vast importance, and it is fraught with as much interest for the student as any tendency in modern legal development. The writer has ventured to suggest as a defect in Judge Thompson's work his failure to exhibit the operation of this more modern conception of public policy in contrast with the older view which treated unauthorized contracts as illegal. This was the fourth point for discussion. A few thoughts derived from a study of this tendency may not be out of place.

If this modern development is treated as being independent of moral considerations, and as being the result of the gradual substitution of a new theory of public policy for the old, a most interesting and important question presents itself. Is the interest of the community best subserved by adhering to the theory that a corporation is a legal person with limited powers, or by disregarding this theory in the determination to enforce all contracts, not immoral, which have been in fact entered into between the parties? If the former view were to prevail, it would follow that contracts made in excess of corporate power or in defiance of statutory prohibition should receive judicial condemnation of a more or less severe character. They might be condemned as being wholly void, or as being merely voidable. In either event, it might be held that their invalidity depended either upon the fact that such contracts are immoral, — *contra bonos mores*, — or that they are illegal merely, without any moral quality. If immoral, then (upon settled principles of law) no recovery could be had by either party from the other, even if the suit were brought in disaffirmance of the contract. If illegal, as being what is somewhat unscientifically called *malum prohibitum* merely, no action could be maintained upon the contract, but before the contract was wholly executed a recovery, with respect to benefits conferred, could be had by a plaintiff in default, and by a plaintiff against a defendant in default — except where the parties were *in pari delicto*. Thus, conceivably, three distinct developments might take place in pursuance of this fundamental conception of public policy. (1) An unauthorized or pro-

hibited contract might be treated as voidable, and not void. No court seems to have developed this theory, except as respects the question of agency which is involved between stockholders and directors when such a contract is made. On this point, as is well known, there have been many decisions, — especially in England, where Ashbury Ry. Carriage Co. *v.* Riche[1] settled the law upon its present footing. (2) An unauthorized or prohibited agreement might be treated as immoral. In that event, no action would lie against the corporation or in its favor for a breach of the contract; nor could a suit be maintained by either party for benefits conferred thereunder. It has been seen that this is declared by Judge Thompson to have been the "ancient doctrine" upon this subject. No authorities which support this position are cited by the learned author, and none are known to the present writer. (3) An unauthorized or prohibited agreement being "unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation, is incapable of making it,"[2] the courts would refuse to permit an action to be maintained upon the void agreement, but would permit a recovery in quasi contract. That is to say, the courts would recognize the right of a plaintiff who had performed his part of an agreement to be put into the *status quo* as respects a defendant who refused to perform, — unless, indeed, the nature of the case were such that the parties would be treated as *in pari delicto*. The courts would also, on such a view, recognize the right of a plaintiff who was unwilling to perform the illegal contract to sue a defendant not in default and recover from him the money or property with which the plaintiff had parted.[3] This doctrine bears a resemblance to what Judge Thompson[4] styles "the more modern doctrine," which is a result of the "revolt" above described. No jurisdiction is known to the present writer, however, in which this doctrine is recognized in its completeness. After the decision in Pearce *v.* R. R., it seemed as if the Supreme Court of the United States would adhere to this line of development, and a strong assertion of the essentials of the doctrine is to be found in the language of Mr. Justice Gray in Central Transportation Co. *v.*

[1] L. R., 7 H. L. 653.

[2] Mr. Justice Gray in Central Transportation Co. *v.* P. P. Car Co., 139 U. S. 24, 59 (1890).

[3] In Keener on Quasi Contracts (p. 273, n.) there is a suggestion to the effect that this is the true position for a court to take if an *ultra vires* contract is to be treated as unenforceable.

[4] Page 391.

Pullman's Palace Car Co.[1] Unfortunately, however, the symmetry of the development was marred by other language in the opinion, which seems to recognize a right to recover on what is called an "implied contract" in cases where it is admitted that recovery on the express contract will not be allowed, and where it seems demonstrable that, consistently with settled principles, there can be no recovery in quasi contract.[2] This would be an anomaly. Except in these particulars, however, Judge Thompson's "modern doctrine" has been the doctrine of the Supreme Court of the United States from the beginning.

If we turn to the second of the two possible views of public policy in respect of corporate contracts, we must expect to find an entirely different development. When a court makes up its mind to enforce, as between the parties, a contract which is wholly foreign to the business of the corporation, and perhaps specifically prohibited by statute, it must be prepared to deal, sooner or later, with two legal problems. In the first place, there is the difficulty which results from the theory of special capacities. Under this theory, which is strongly asserted in a multitude of American cases,[3] a corporation has no powers except such as are conferred by the grant contained in the charter. Under the doctrine of general capacities, the effect of incorporation is to create a legal person with the powers of every other legal person with respect to contracts, subject to such prohibitions upon the exercise of certain powers as the charter may impose. Under the former theory a corporation has power to make certain contracts only, and, by supposition, the suggested contract is not one of them. Without power there can be no contract. If there is no contract, there is nothing to enforce. It is the case of the contract of a married woman. This difficulty can, in the judgment of the writer, be overcome in one way only, — by discarding the doctrine of special capacities and by adopting the doctrine of general capacities. A corporation would then stand upon the footing of a natural person, with power to make every kind of contract, subject to such penalties as the sovereign might impose for violating prohibitions

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[1] *Supra.*

[2] See 2 Am. Law Reg. & Rev. (N. S.) 296, for a discussion of this point by the present writer.

[3] For example, in Thomas *v.* R. R. Co., 101 U. S. 71; refusing to assent to the argument of counsel for plaintiff, who made a strong plea for the recognition of the doctrine of general capacities.

upon making any particular form of contract. If a banking corporation were forbidden to do an insurance business, but nevertheless issued a policy, it would be perfectly reasonable for the courts to permit the assured to recover against the company upon the ground that the prohibition did not involve the invalidity of the contract as a penalty,[1] but that the prohibition was merely a condition subsequent in the grant of franchises by the sovereign, for a breach of which the sovereign might resume them if desired. It is well known that the doctrine of general capacities is the doctrine of the English courts; but those courts have treated the designation of a field of activity in the charter as a statutory prohibition against engaging in any other field of activity, and they have steadfastly refused to enforce all prohibited contracts. In other words, they have maintained the legal theory in its integrity, but they have deemed that the doctrine of general capacities must be held in check by some vigorous rule of contrary tendency, lest corporations should become all powerful. Of the English courts, therefore, it may be said that their adherence to the doctrine of general capacities is no indication of sympathy with the second view of public policy under discussion. With them this theory of corporate power is the result of a conviction that it best accords with the common law theory of the effect of incorporation.[2] It follows that, while the result of the English decisions could, on principle, be reached equally well on the doctrine of special capacities, yet the American decisions which proceed upon the policy now under discussion can be justified, on principle, only on the doctrine of general capacities, coupled with the view that a prohibition, express or implied, is a collateral condition or penalty to be enforced by the State. The American courts, nevertheless, are constantly asserting the doctrine of special capacities in much the same language as that used by Judge Thompson, while at the same time they are enforcing between the parties contracts which are not merely unauthorized, but actually prohibited. In other words, they sacrifice legal theory in the interest of their chosen policy.

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[1] The Supreme Court of the United States in a well known case, National Bank *v.* Matthews, 98 U. S. 621 (1878), took this view of the provision in the National Banking Act forbidding banks to lend money on real estate security. See also the language of Mr. Justice Field in National Bank *v.* Whitney, 103 U. S. 99 (1880).

[2] See for a discussion of this point the Appendix on "Limits of Corporate Power" in Pollock on Contracts.

The second legal obstacle which the courts must meet and overcome, if the view in question is to prevail, is the resulting difficulty of maintaining any theory whatever which places limitations upon the corporate power to contract. It will be observed that the exigencies of the policy under discussion require the courts to enforce *ultra vires* contracts as between the parties, leaving the State to institute proceedings, by *quo warranto* or otherwise, to deprive the offending body of its charter. But in point of fact, in ninty-nine cases out of a hundred the State has no real interest in the matter. Even in those cases in which we lawyers are accustomed to speak most glibly of "public interest," it often happens that the conventional conception of the interest of the community is just the reverse of its interest in fact. Take the case of a railway lease which has not been specifically authorized. The lessor refuses to perform certain covenants, and an effort is made to compel specific performance. In no jurisdiction will the desired decree be made, because it is the conventional view that the public is interested in seeing to it that no one but the original grantee of the franchise shall exercise it. Suppose the offer is made to prove by affidavit, or otherwise, that the entire community affected is anxious that the lease should be enforced. The offer is of course rejected by the court. It may be assumed to be clear that, upon submitting the documents in the case to the legislature, an enabling act authorizing the lease could have been had for the asking. The fact remains that corporations are driven to the legislature in these cases to seek protection from the courts.[1] The reason for the persistence of the theory that a franchise of a public nature is inalienable without the consent of the sovereign is not altogether clear. As yet no court has been found so iconoclastic as to shatter the venerable doctrine.[2] But, as has been said, the cases in which the public and the State have a direct interest, even by convention, are far from numerous. In the absence of direct interest there is no reason to expect active interference with corporate activity in any considerable number of cases. There is even a decision in the books in which the right of the State to forfeit a charter

[1] Central Transportation Co. *v.* Pullman's Palace Car Co. is a striking illustration of this. There the legislature had passed an act specially enabling the lessor corporation to make the lease in question, but the court nevertheless held that the authority was not sufficiently explicit.

[2] See the dissent of Mr. Justice Bradley in Penna., &c. R. R. *v.* St. L. A. & T. H. R. R., 118 U. S. 290.

in such a case is denied. We should then have a law practically without a sanction in the matter of restraint upon the making of corporate contracts. This state of affairs is to some extent recognized; but it does not seem to be perceived that a significant alternative is presented to the judges in consequence of it. Shall the courts continue to maintain some theory of limited corporate power, or shall they take the absence of real public interest in so vast a number of cases as an indication that the so called "law of *ultra vires*" has survived whatever usefulness it may have possessed? Apparently unconscious of the existence of this problem, the courts have undertaken the task contemplated by the former alternative, and have set themselves to discourage unauthorized and prohibited contracts by enforcing them between the parties only in favor of one who has performed his part. Readiness to perform is not enough: the contract must be executed in part before the judge will give it recognition. Here is a fruitful source of litigation. What constitutes execution within the meaning of the rule? Is execution synonymous with that "passage of money or property" which would give rise to a cause of action in quasi contract, even under the former of our two conceptions of public policy? These and many other similar questions confront the courts in their attempt to signify a qualified disapproval of unauthorized or prohibited contracts.

What of the second alternative? Is there any reason, on principle, why the courts which believe in treating the prohibition as a condition should not carry out the theory to the end, and enforce all corporate contracts pricisely like other contracts, and subject only to the limitations which the general law of contracts recognizes? It seems to the writer that, if the doctrine of general capacities were once adopted, a strict adherence to our second line of policy would lead legitimately to that result. Some of the considerations in favor of the doctrine of general capacities have already been advanced. It remains to determine whether harm would result from the removal of all restraint from the corporate power to contract, — whether, in other words, society would be the loser through the death of the whole law of corporate power and *ultra vires*. It is interesting to note that Judge Thompson is to be found upon the negative side of this question. "My own view," he says,[1] "is that the doctrine of *ultra vires* has no proper place in the law

[1] pages 397, 398.

of private corporations, except in respect of contracts which are *bad in themselves*, the making of which are [*sic*] prohibited by considerations of public morality, of justice, or of a sound public policy, and which therefore stand upon such a footing that neither party can be regarded as innocent or blameless in entering into them." This is the same thing as saying that doctrines of corporate power should no longer exist in any case, for the qualifications enumerated by the learned author already obtain in the case of contracts between man and man. It is somewhat difficult to perceive just how Judge Thompson reaches his conclusion upon principle, for he seems to have but a hazy conception of the two great theories of corporate power, and it is not clear that he even perceives the importance of working out his result upon one or the other of them. His view may be accepted, however, as an evidence of what is believed to be the general sense of the American world to-day; namely, that society is vastly more interested in the adjustment of the actual relations subsisting between corporations and individuals than in the maintenance of fancied relations between corporations and the State. The franchise to be a corporation is no longer in the hands of favorites of the Crown. It is no longer true that the owners of this franchise have their brethren at their mercy, or even that they occupy a position of peculiar advantage as compared with them. Corporate activity has taken its place in the mercantile world side by side with individual enterprise, and the two work together on equal terms. There are many aggregations of capital which do not take on the corporate form; while, on the other hand, behind the corporate machinery of many a gigantic enterprise stands a single individual, who has become the owner of all, or almost all, the shares. It is indeed to the interest of the State that these business ventures should succeed, and it may be said that the scope of their activity should therefore be circumscribed. But surely the question of what branches of business should or should not be combined together is not a question for the courts. The mercantile world must be left to work out the solution of this problem for itself. If, when the problem is solved, it is found that the union of two forms of business enterprise (as, for example, banking and insurance) is fraught with peculiar danger to the public, the case becomes one that is appropriate for legislation; and specific measures may then be adopted in order to deal with the difficulties which present themselves. Moreover, it must not be forgotten that, independently of these considerations, it remains

true that a dissenting minority of stockholders would still have all the rights of a partner in respect of confining his associates to the enterprise to which he agreed to contribute his capital. This is not a case in which partnership law has drawn upon corporation law for its conception of limitations upon the power of the majority. The reverse has been the case, as may be seen by a consideration of Lord Eldon's decision in Natusch *v.* Irving.[1]

The observations which have just been made in regard to legislative declarations of policy with respect to particular forms of enterprise are of course applicable to the case of quasi public corporations. Where the nature of the business is such that the public has an interest in the conduct of it, it seems not unreasonable to insist that the business shall be regulated *as a business*, and not with reference to the fact that it is carried on by a corporation. It is settled that a strictly private corporation may mortgage its property and "plant," unless prohibited. It is said to be equally well settled that a corporation with public duties to perform, as, for example, a railroad, cannot make a valid mortgage contract unless specifically authorized. The reason assigned is that a mortgage "may ripen into a sale," and that in the latter case a sale means that the railroad can no longer perform its duties to the public. In the judgment of the writer, it is altogether unphilosophical to make this distinction the basis of a judicial development of a doctrine of corporation law. If the distinction is really of any importance, it should be made the subject of a legislative enactment regulating the management of railroads. The prediction may be hazarded that before twenty-five years have passed away our courts will have manifested a disposition to depart from the present basis of decision, and that they will have indicated an intention to abandon the attempt to regulate a business by developing the law relating to one out of several agencies by which, conceivably, that business may be carried on.

It must not be forgotten, however, that the latter part of this discussion has been concerned with the *possible* rather than with the *actual* in corporation law. In point of fact, there is a grand division of jurisdictions upon the primary question of public policy outlined above. The Supreme Court of the United States,[2] the Supreme Courts of Massachusetts,[3] Alabama,[4] and a few other States, have

[1] Gow on Partnership, App., p. 398, ed. 3.

[2] Central Transportation Co. *v.* Pullman's Pal. Car Co., 139 U. S. 24.

[3] Davis *v.* Old Colony R. R. Co., 131 Mass. 258.

[4] Bank *v.* Dunkin 54 Ala. 471.

declared themselves definitely in favor of maintaining existing restrictions upon the corporate power to contract. They have, in general, refused to enforce unauthorized or prohibited contracts, even in favor of the party who has fully performed. The doctrine is entirely intelligible and consistent, and, in the main, it has been consistently applied. In a few cases, however (as has been seen), there are either dicta or actual decisions which seem to mar the symmetry of the system. If this doctrine becomes obsolete it will be the result, not of any inherent defects of structure, but because it is not in touch with the needs and requirements of the business world. In Pennsylvania,[1] on the other hand, and in New York,[2] New Jersey,[3] Indiana,[4] Illinois,[5] Minnesota,[6] Kansas,[7] and in many other jurisdictions, the courts have manifested a tendency to give a qualified adherence to the second theory of public policy, — hesitating to ignore altogether the legal restrictions upon corporate power, but refusing to permit the party who has received a benefit to take advantage of the defect of power when a suit is brought to enforce the contract. The position of these courts of the second group is believed by the writer (as has been pointed out above) to be unsound upon principle, unless the theory of general capacities is adopted; and unsound even then unless it is pushed to its legitimate conclusion, with the result of enforcing all corporate contracts, even when they are wholly executory, in every case where a contract between individuals would be enforced. In point of fact, the courts of the second group endeavor, in general, to work out the ends of justice upon the basis of a theory of estoppel. Where a corporation has received a benefit under a contract, it is said to be "estopped" from pleading the fact that the contract was unauthorized (or, in some cases, even that it was prohibited) as a defence to an action brought to enforce the agreement. This view seems to be open, upon principle, to certain serious objections. In most jurisdictions the courts are definitely committed to the position that those who deal with corporations are charged with notice of the limits of corporate power. In contemplation of law, when A.

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[1] Wright *v.* Pipe Line Co., 101 Pa. 204.
[2] Holmes, etc. Mfg. Co. *v.* Metal Co., 127 N. Y. 252.
[3] Camden, etc. R. R. Co. *v.* Mays Landing R. R. Co., 48 N. J. L. 530.
[4] State Board of Agriculture, *v.* Citizens' R. R. Co., 47 Ind. 407.
[5] Heims *v.* Flannery, 137 Ill. 309.
[6] Auerbach *v.* Mill Co., 28 Minn. 291.
[7] Sherman, etc. Town Co. *v.* Morris, 43 Kan. 282.

makes an unauthorized or prohibited contract with a corporation he does it with his eyes open. He takes the risk attendant upon inability to enforce the agreement in a court of justice. It is accordingly somewhat difficult to manipulate the doctrine of equitable estoppel in his favor, in view of the fact that the act of the corporation was not the inducing cause of his present position. Nor does it help matters much to discard the theory that the chartered powers of a corporation are included in the citizen's stock of presumptive knowledge. A court must either go further than this, and declare that the public is presumed *not to know* what a corporation may lawfully do, or else the judges must prepare to receive proof in a particular case that the limitations of the charter were in fact brought home to the plaintiff. Of course it may be said, and it sometimes is said, that in these cases the term "estoppel" is not used in its technical sense. If this is true, the use of a scientific term in any other than its technical sense is perhaps open to criticism. It is said, for example, that this doctrine is applied "only for the purpose of compelling corporations to be honest in the simplest and commonest sense of honesty." [1] This means, presumably that corporations will not be permitted to do a wrong which would not be sanctioned in the case of an individual. The language just quoted occurs in a case in which a mining corporation borrowed money in order to engage in business in a place not authorized by its charter. A bill was filed by a stockholder to enjoin the prosecution of a suit by the lender upon the evidence of indebtedness. But if under similar circumstances an individual were to attempt to enrich himself unjustly under an illegal contract which was *malum prohibitum*, it would not be upon the basis of estoppel that his attempt would be frustrated by the courts. The contract would not be enforced, but a recovery in quasi contract would be permitted. If the courts which echo the language of Chief Justice Lawrence were strictly logical, they would either assimilate their views to those which the Supreme Court of the United States professes to hold; or else, at the other extreme, they would discard the view that corporate power is in its nature limited, and would embrace the radical doctrine which was advocated above.

This tendency to work out results upon the basis of a species of primitive estoppel is, however, a tendency which is not without

[1] Chief Justice Lawrence, in Bradley *v.* Ballard, 55 Ill. 413.

interest. A result more strictly "equitable" might perhaps be reached if the courts were to hold that a corporation, by contracting, warrants its power and right to enter into the agreement. Suppose, for example, that a corporation makes a prohibited contract. In the face of the prohibition the contract will not be specifically enforced. Nor will the plaintiff be permitted to maintain an action upon it. Rights of recovery in quasi contract, however, are not broad enough to meet the requirements of the case. The corporation will accordingly be treated as having warranted its power and right to make the agreement. The subsequent assertion of a lack of power and right, although theoretically effective so far as disposing of the plaintiff's suit is concerned, now becomes a clear breach of the warranty. The measure of damage in an action for this breach is the value of the contract which the plaintiff has lost. This includes prospective profit and the loss of a bargain. Thus the plaintiff in such a case has every right except the right of specific performance. It goes without saying that such a theory presupposes the abandonment of the view that all the world has notice of the limits of corporate power. It is, of course, a somewhat fanciful theory, but it furnishes an interesting basis for a comparison with the modern German conception of damage by reason of the non-existence of contract, — "the negative interest of contract," as Jhering calls it (Negatives Vertragsinteresse). According to that conception, if A. leads B. to believe that there is a contract when, owing to facts which B. neither knows nor is bound to know, there is not, A., however innocent, is liable for the damages sustained by B. "He [A.] is not liable on the contract, for there is none; nor is he bound to put the other party in as good position as if he had a contract; but he is bound to put the other party in as good position as if there had never been a simulacrum of contract." [1]

If we return from the domain of theory to our final survey of existing conditions in American courts, it seems hard to escape a conclusion favorable to the view which results in the enforcement in so many cases of unauthorized and prohibited contracts. Incomplete

[1] The language cited is that of Professor Munroe Smith of the Faculty of Political Science in Columbia College, to whom the writer is indebted for this reference to German law. Professor Munroe Smith adds: "I do not find that any German jurist has suggested the extension of the above principle to cases where a contract is void (or voidable) because of incapacity. Perhaps they regard these cases as falling under the restriction of 'grounds of invalidity which the other party was bound to know.'"

as it is, this doctrine seems to represent far better than the other the enlightened sense of the business world, and the prediction is hazarded that it is destined in its full development to be the doctrine of the future. But while it seems clear that we are still in the midst of the evolution of this department of corporation law, it is yet not impossible to discover the principles upon which that evolution proceeds. It is for this reason that the writer ventures to dissent from the view of Judge Thompson, that "the Anglo-American law upon this subject" is in a state of "hopeless and inextricable confusion." Nor does it seem to the writer to be true "that contradictory decisions are constantly rendered by the same courts; that opposing principles, tending to contrary results, jostle and crowd each other as the ice floes jostle and crowd each other going southward out of Baffin's Bay through Davis Straits; and that the judge seizes upon one of these principles to-day, and to-morrow upon another, and enlarges it or applies it according to the seeming exigencies of justice in that particular case." It is submitted, on the contrary, that the decisions upon corporate power are susceptible of scientific analysis and classification. It is, however, necessary that the investigator should give up the attempt to relegate this subject to the realm of moral reform, and that he should be content to see in it only the familiar spectacle of a gradual legal development brought about by a conflict between opposing views of public policy.

George Wharton Pepper.